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BEFORE THE
POSTAL REGULATORY COMMISSION

PERIODIC REPORTING (PROPOSAL TWELVE)	**Docket No. RM2016-3**

COMMENTS OF UNITED PARCEL SERVICE ON RULEMAKING ON ANALYTICAL PRINCIPLES USED IN PERIODIC REPORTING (PROPOSAL TWELVE)

(December 4, 2015)

United Parcel Service, Inc. ("UPS") hereby provides comments pursuant to Order No. 2836 and in response to Proposal Twelve by the United States Postal Service, regarding its periodic reporting obligations with respect to vehicle costs for city carrier and other use.

At the outset, UPS notes the exceptionally short timeframe for this rulemaking proceeding, which allows just ten days for initial comments and an additional five days for reply comments. While UPS understands that this issue was not technically ripe prior to the Commission's order in RM2015-7 on October 29,[1] and that the Postal Service would prefer to implement Proposal Twelve in time for the Annual Compliance Report for FY 2015, UPS urges the Commission to adopt no more than temporary conclusions in this docket, as there are serious questions regarding the continued use of city carrier labor costs as a proxy for vehicle costs, and vehicle costs will only grow in

[1] Dkt. No. RM2015-7, Order No. 2792, Order Approving Analytical Principles Used in Periodic Reporting (Proposal Thirteen) (Oct. 29, 2015) ("Order 2792").

importance as the Postal Service replaces nearly its entire vehicle fleet of some 200,000 vehicles over the next several years.

Proposal Twelve, like Proposal Thirteen, Suffers From Serious Conceptual Flaws and Untested Assumptions

Proposal Twelve would update the incumbent analytical principles for assigning vehicle costs to products, which currently use the distribution of city carrier labor costs as a proxy for assigning cost responsibility for vehicle usage.[2] The Postal Service asserts without support that "a strong association exists between" "direct [city carrier] labor and vehicle costs."[3] Petition at 1. The Postal Service claims in its petition that the (conditional) adoption of Proposal Thirteen in the city carrier docket has changed the attribution of these costs.[4] The Postal Service argues that the attribution of three related vehicle cost segments needs to be updated in order to make their treatment consistent with that of Proposal Thirteen.

There are, however, at least three serious conceptual problems with the Postal Service's proposal.

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[2] Dkt. No. RM2016-3, Petition of the United States Postal Service for the Initiation of a Proceeding to Consider Proposed Changes in Analytical Principles (Proposal Twelve) at 1 (Nov. 20, 2015) ("Petition").

[3] The Postal Service does not support this statement with any evidence, but does note that the treatment of vehicle costs was adopted a decade ago in R2005-1. While vehicle costs appeared in Postal Service evidence in that rate case, the Commission did not specifically address vehicle costs when it reluctantly approved the prior, error-riddled version of the city carrier costing model.

[4] "The Commission finds that UPS's concept of a single, unified delivery model warrants further consideration. Accordingly, *tied to its approval of Proposal Thirteen*, the Commission directs the Postal Service to file a report, no later than February 15, 2016, addressing the topics identified in Part IV.D of this Order." Order 2792 at 2-3 (emphasis added).

The first is that, if adopted, the Postal Service's proposal would import into the three affected vehicle cost segments all of the flaws of Proposal Thirteen. These flaws include an artificial division between regular delivery and parcel delivery,[5] and a failure to account for seasonal and other variation in mail and parcel volumes.[6] These and other flaws in Proposal Thirteen lead to less than half of city carrier labor costs actually being attributed to products, with the remainder considered institutional costs that are in large part borne by market dominant mailers. This flaw is carried over to Proposal Twelve, under which only 36 percent of vehicle costs are attributed to products. Captive mailers are thus burdened not only with those costs that are attributed to them, but also with virtually all of the remaining 64 percent of vehicle costs which are classified as institutional, meaning that market dominant mailers are bearing up to 91.7% of the vehicle costs at issue in Proposal Twelve.[7] These institutional costs are also ignored for the purposes of the anti-subsidization prohibitions of 39 U.S.C. § 3633(a)(1) and (a)(2).

The second problem is that the Postal Service's proposal relies upon the untested and increasingly untenable assumption that vehicle costs are driven by the

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5 Order 2792 at 43 ("[Q]uestions remain as to whether [Proposal Thirteen] fully captures the effects of volume on street time costs. In particular, UPS's analysis suggests that the Postal Service's calculations do not thoroughly reflect actual interactions between regular delivery and parcel delivery.").

6 Order 2792 at 59 ("UPS asserts that the analysis should cover a time period long enough to capture substantial changes in route structure, which are a direct reflection of sustained changes in volume. . . . The Commission supports the development of reliable operational data for each ZIP Code-day which would allow all days within a year to be used to estimate volume variabilities. This would increase the Postal Service's ability to measure both the short-and long-term effects of changes in volume.").

7 ((.36*.87) + (.64*.945)) = 91.7%, where 87% is the percentage of attributable costs attributed to market dominant products and 94.5% is the total amount of institutional costs minus the 5.5% appropriate share of institutional costs that competitive products must bear.

same factors that drive city carrier labor costs. While this may have been an acceptable approximation in an earlier era in which the mail stream was more uniform and parcels made up only a tiny portion of that mail stream, this assumption does not apply in the present environment in which parcels and parcel-dominant routes are making up an ever-increasing share of the Postal Service's business. For example, the Postal Service is increasingly relying on unconventional and non-city carrier routes to handle the growing volume of parcels,[8] and putting its vehicles to work in more diverse ways than ever before.[9] An example of such a diverse use is grocery deliveries that take place between 3 am and 7 am, at a time when vehicles are not being used for city carrier routes.[10] Proposal Twelve's changes regarding Special Purpose Routes ("SPR") do not adequately address the issue. Under Proposal Twelve, 58% of costs in the SPR-

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[8] The Postal Service has delivered parcels on at least 104 million Special Purpose Route runs since 2013, mostly on Sundays and during the peak holiday season, U.S. Postal Service, *Dynamic Deliveries* (Nov. 18, 2015), https://link.usps.com/2015/11/18/dynamic-deliveries/, but also on normal delivery days when an overloaded vehicle cannot fit all the mail and parcels for a given route and two trips are necessary. Laura Stevens, *For FedEx and UPS, a Cheaper Route: the Post Office*, WALL ST. J., (Aug. 4, 2014), http://www.wsj.com/articles/u-s-mail-does-the-trick-for-fedex-ups-1407182247 ("[S]ome mail carriers tend their routes twice a day, once with letters and once with packages.").

[9] Laura Stevens, *U.S. Postal Service Tries Hand as Fishmonger, Grocer*, WALL ST. J. (Aug. 17, 2015), http://www.wsj.com/articles/u-s-postal-service-tries-hand-as-fishmonger-grocer-1439855940 ("In New York City, letter carriers in the early morning hours load boxes of fresh and frozen seafood from Fulton Fish Market onto mail trucks and deliver them to local restaurants by 11 a.m. They collect packages from Internet electronics retailer Newegg Inc. for fast, local afternoon delivery. They're also doing daily water delivery to businesses for Nestlé SA in Manhattan and Brooklyn.");

[10] Greg Bensinger and Laura Stevens, *U.S. Mail Delivers Amazon Groceries in San Francisco*, WALL ST. J. (SEP. 4, 2014), http://www.wsj.com/articles/u-s-mail-to-deliver-amazon-groceries-in-san-francisco-1409854499 ("A spokeswoman said the USPS is making the drop-offs between 3 a.m. and 7 a.m.; few of its trucks are in use at those hours.").

related vehicle cost pools continue to be treated as institutional, while less than 25% of total costs are attributed to competitive products.

The third problem is related to the previous two, and concerns the Postal Service's position in Proposal Thirteen that a portion of city carrier street time is fixed with respect to volume because it is devoted to traversing a letter carrier's route.[11] When a vehicle is used on a city carrier route (as opposed to the other diverse uses to which USPS vehicles are currently subject), the vehicle cost associated with traversing the route depends on factors other than city carrier labor time, including the distance traveled and the fuel economy of the vehicle — which is in turn dependent on the size, weight, and cubic volume of the vehicle and of the mail and parcels being transported. Depreciation charges will depend of the acquisition cost of the vehicle, which in turn is also related to size, weight, and cubic volume. Thus, vehicle costs will be largely determined by the size and weight of the vehicle and the volume and mix of mail transported in it. Clearly, Proposal Twelve ignores important vehicle cost drivers and overstates the extent to which vehicle costs are fixed.

The Postal Service's Parcel-Oriented Vehicle Purchases Illustrate the Defects of Proposal Twelve

The Postal Service is in the process of acquiring new vehicles specifically intended for parcel delivery. The Postal Service recently ordered 9,113 large vans for parcel delivery,[12] and is in the Request for Proposals (RFP) stage for the procurement

[11] This argument fails to consider that longer-term changes in route structure and pivoting negates the claim that traversing the route is fixed with respect to volume.

[12] Larry Vellequette, *Postal Service to Buy 9,113 Ram ProMaster Vans for Large Package Delivery*, AUTOMOTIVE NEWS (Sep. 29, 2015), http://www.autonews.com/article/20150929/RETAIL/150929815/postal-service-to-buy-

of up to 180,000 new delivery vehicles, called Next Generation Delivery Vehicles ("NGDV"). Both vehicles were or are specifically being designed and purchased to handle growing parcel volume.

That the new large vans and the NGDVs are primarily intended for parcel delivery is beyond question. Postal Service CFO Joseph Corbett recently testified before Congress that "[a]s packaging and shipping continue to be an area of revenue growth, it will be important for USPS to invest in vehicles to effectively serve that market."[13] Similarly, the Postal Service recommended at its NGDV Supplier Design Conference that the vehicle have "sufficient capacity to allow the vehicle to be loaded only once,"[14] avoiding the current problem of the current small Long-Life Vehicles ("LLVs") often having to be loaded multiple times per day.[15] With market dominant mail volume in a steep decline, this phenomenon is obviously driven by the rapid growth in parcel volumes.

9113-ram-promaster-vans-for-large-package. With a Manufacturer's Suggested Retail Price of $33,625, Ramtrucks.com (last accessed Dec. 2, 2015), http://www.ramtrucks.com/hostc/bmo/CUT201600/models.do?, this order suggests about $300 million in costs intended to benefit the Postal Service's competitive business.

[13] *Best Practices in Federal Large Vehicle Fleet Administration and Procurement: Hearing Before the Subcomm. on Govt. Operations* (May 21, 2015) (Testimony of Joseph Corbett, Chief Financial Officer, U.S. Postal Service), https://oversight.house.gov/wp-content/uploads/2015/05/Mr.-Corbett-USPS-Testimony-Bio1.pdf.

[14] Presentation, *U.S. Postal Service Next Generation Delivery Vehicle Supplier Conference* at 4 (Feb. 18 2015), https://files.govtribe.com/fbo/e4c65069740a6b4df5158fb0a9512b1c/52dca17499d0b2141b0d4ec1032a05d0.

[15] *See* supra note 8.

Larger vehicles designed for package delivery, such as the NGDV, are inherently more expensive both to purchase, fuel, and to maintain.[16] For example, the USPS Inspector General estimated that a “suitable standard [*i.e.*, non-custom] commercial vehicle even with a small amount of customization and a host of new safety features, would cost less,” finding that a basic cargo van costs just $21,000.[17] However, larger vehicles to accommodate USPS’s increased parcel capability needs, especially a custom-made vehicle like the NGDV, are projected to cost up to $35,000 per vehicle, nearly double the price.[18] It is also important to note that the increased acquisition, fuel, and maintenance costs are only part of the costs incurred for larger vehicles — they also require additional parking space and potential reconfiguration of the Postal Service’s Destination Delivery Units, which may represent a substantial capital expenditure.

Proposal Twelve also forces onto captive market dominant mailers the costs of purchasing, maintaining, and depreciating parcel-focused vehicles, at the worst possible time. Market dominant mailers are experiencing higher rates than ever, and are

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[16] Larger vehicles, especially a custom build like the proposed NGDV, generate greater up-front cost due to increased size and capacity, as well as greater long-term maintenance and parts costs. Custom builds will also have fewer available suppliers for parts, driving costs up further. Further, all else being equal, larger vehicles have inherently lower fuel economy than smaller vehicles.

[17] U.S. Postal Service Office of Inspector General, *Management Advisory Report: Delivery Vehicle Fleet Replacement* at 10 (Jun. 10, 2014), https://www.uspsoig.gov/sites/default/files/document-library-files/2015/dr-ma-14-005.pdf.

[18] Rich Piellisch, *Post Office Qualifies 15 for the NGDV*, FLEETS & FUELS (Apr. 27, 2015), http://www.fleetsandfuels.com/solicitation/2015/04/post-office-qualifies-15-for-the-ngdv/.

increasingly concerned with shouldering costs that do not benefit them.[19] In fact, mail volumes have declined as a whole and on a per-route basis, suggesting that if not for increases in parcel volumes, the Postal Service would likely be purchasing a much smaller and less-expensive NGDV.[20] The adoption of Proposal Twelve would maintain outdated costing models that allow the Postal Service to allocate the cost of parcel-focused vehicles disproportionately away from parcels and onto market dominant mailers. This is directly contrary to the anti-subsidization prohibitions in the Postal Accountability and Enhancement Act. It is also financially unsustainable, as declining mail volume and record-high rates mean that market dominant mailers cannot indefinitely pay for vehicles designed in large part for parcel delivery. It is incumbent upon the Commission to ensure that all additional costs caused by the Postal Service's parcel business, including elevated vehicle acquisition and operating costs, are attributed to those products.

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[19] Market dominant mailers continue to express concerns about the transparency and accuracy of the Postal Service's costing methodologies. *See, e.g.*, Dkt. No. ACR2014, PostCom Initial Comments at 3-5 (Feb. 2, 2015).

[20] Even with a parcel-focused NGDV, a smaller vehicle would be appropriate and cost-effective in delivering the mail for some routes. For example, a recent report by Securing America's Future Energy, a nonpartisan energy think tank, found that a more flexible approach to the Postal Service's fleet replacement, including the use of smaller vehicles where route-appropriate, would save the Postal Service an estimated $1.9 billion over the next 25 years through lower maintenance costs and higher fuel efficiencies. Securing America's Future Energy, *USPS Fleet Procurement for the 21st Century* (Sep. 28, 2015), http://www.secureenergy.org/sites/default/files/SAFE_USPS_Issue_Brief_September_2015_0.pdf.

<u>Other Factors Are Superior Vehicle Cost Drivers to Using City Carrier Labor Costs As a Proxy</u>

As this docket has such a short timeline, it is challenging to present detailed analytical principles that can be used to replace Proposal Twelve and its use of city carrier labor costs as an unsupported proxy for vehicle costs. Two alternative methodologies are outlined below; however, the list is not exclusive, and further evaluation is likely necessary.

First, the Postal Service could attribute costs based on cubic volume rather than city carrier labor. This methodology is already being used by the Postal Service to attribute purchased transportation costs, which are significantly driven by piece size. The Postal Service's pursuit of greater interior vehicle volume indicates that vehicle purchase and maintenance costs are driven more by cubic volume than by piece counts or labor hours, and that cubic volume is a better predictor of vehicle costs than continuing to piggyback these costs onto city carrier labor costs, which are characterized by an entirely different pattern of cost causation.

Second, the Postal Service could also determine the difference in cost for a mail delivery vehicle and a parcel delivery vehicle,[21] and the additional incremental costs for a parcel delivery vehicle could be directly attributed to parcels.[22] The cost differences

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21 For example, the difference between the cost of an updated LLV with a cubic capacity of 121 ft^3 compared to the cost of the proposed Next Generation Delivery Vehicle, which will have up to 400 ft^3 capacity. Since the 121 ft^3 capacity proved sufficient for mail volume even at its peak of 213 billion pieces in FY 2006, it is fair to assume that the LLV is sufficient for mail volume, and that additional capacity needs are entirely or almost entirely driven by parcel volume.

22 This is common in other contexts; for example, airport landing fees are often divided among different-sized aircraft where additional runway space is paid for only by those larger aircraft that require it. Pradeep Dubey, *The Shapley Value as Aircraft Landing*

between a mail-focused vehicle and a parcel-focused vehicle, and the Postal Service's pursuit of strictly parcel-focused vehicles, indicates that competitive considerations are becoming the primary cost-driving consideration for vehicle acquisition and other costs. Proposal Twelve completely fails to consider this reality.

Each of these suggested methodologies will likely require additional research to validate; however, as the Postal Service has over 200,000 vehicles in its fleet, UPS is confident that the Postal Service has the necessary information to expeditiously present initial conclusions to the Commission.

Conclusion

If the Postal Service is correct that there is a "compelling need" to align vehicle costs with city carrier labor costs for the FY 2015 ACR, and there is insufficient time to explore alternatives to the Postal Service's hastily prepared and submitted proposal, then the Commission should not adopt Proposal Twelve as anything other than a short-term measure applicable to FY 2015 ACR alone. The Commission should reconsider the analytical principles underlying Proposal Twelve once it has reviewed the findings the Postal Service will file in February 2016 in accordance with Order 2792.

Fees-Revisited, MANAGEMENT SCIENCE Vol. 28, No. 8, 869-874 (1982). Similarly, numerous studies of highway costs have recognized that the additional costs incurred in order to accommodate the higher weight loads and increased clearances needed to accommodate truck traffic should be assigned to trucks. Federal Highway Administration, *1997 Federal Highway Cost Allocation Study Final Report* at Chapter 5: Cost Occasioned Approach (1997), http://www.fhwa.dot.gov/policy/hcas/final/five.cfm ("Traditionally, cost allocation studies at both the Federal and State levels have examined highway agency costs because their primary objective has been to determine the cost responsibility of different vehicles for infrastructure and related costs borne by the highway agency. This cost recovery objective in turn is related to the user fee principle that different vehicle classes should pay for the highway infrastructure in proportion to their share of the costs to provide and preserve that infrastructure.").

The Commission should not permit the Postal Service to permanently impose its increasingly arbitrary assumption that the elasticity of vehicle costs is equivalent to that of labor costs. Importing Proposal Thirteen's flawed methodology into vehicle costs through Proposal Twelve will only embed more errors within postal costing methodology, and lead to under-attribution to products. In addition, there are serious questions as to whether city carrier labor costs are a fitting proxy for vehicle costs, especially when the Postal Service's vehicles are being used for more diverse purposes than ever.

The replacement of 85% of the Postal Service's fleet through the NGDV is a generational purchase with long-term ramifications, and deserves focused and advance examination. The Commission should require the Postal Service to file a report for significant new vehicle procurement, including for the NGDV, with a detailed explanation of how those expenditures will be paid for over the life of the vehicle, including estimated depreciation schedules, expected maintenance, and fuel costs. This increased level of transparency will improve the ability of all affected parties to understand the short- and long-term cost implications of these significant Postal Service investment decisions.

Rather than enshrining outdated methodologies to allocate acquisition, operating, and maintenance costs of "UPS sized and style vehicles" almost completely to captive monopoly mailers,[23] UPS urges the Commission to consider and adopt a cost attribution

[23] Mike Colgan, *Familiar White Postal Service Trucks Too Small For Increasing Amount Of Parcels Being Mailed*, CBS (Jan. 19, 2015), http://sanfrancisco.cbslocal.com/2015/01/19/familiar-white-postal-service-trucks-too-small-for-increasing-amount-of-parcels-being-mailed/.

methodology that properly reflects the increasing focus of vehicle use for competitive purposes.

Respectfully submitted,

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